FAIR ISAAC CORP
Form 10-Q
January 30, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2018
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 1-11689

Fair Isaac Corporation
(Exact name of registrant as specified in its charter)

Delaware	94-1499887
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
181 Metro Drive, Suite 700 San Jose, California	95110-1346
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: 408-535-1500

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ý No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer	ý	Accelerated Filer	o
Non-Accelerated Filer	o	Smaller Reporting Company	o

Emerging Growth Company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes ý No

The number of shares of common stock outstanding on January 18, 2019 was 29,071,202 (excluding 59,785,581 shares held by us as treasury stock).

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements
FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	December 31, 2018	September 30, 2018 As Adjusted
	(In thousands, except par value data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 79,896	$ 90,023
Accounts receivable, net	247,566	266,742
Prepaid expenses and other current assets	48,380	39,624
Total current assets	375,842	396,389
Marketable securities	17,210	18,059
Other investments	1,679	1,697
Property and equipment, net	46,864	48,837
Goodwill	798,793	800,890
Intangible assets, net	12,910	14,536
Deferred income taxes	14,066	13,805
Other assets	38,262	36,254
Total assets	$ 1,305,626	$ 1,330,467
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$ 20,387	$ 20,251
Accrued compensation and employee benefits	55,354	84,292
Other accrued liabilities	26,079	31,025
Deferred revenue	103,527	103,335
Current maturities on debt	228,000	235,000
Total current liabilities	433,347	473,903
Long-term debt	604,157	528,944
Other liabilities	40,227	40,183
Total liabilities	1,077,731	1,043,030
Commitments and contingencies		
Stockholders’ equity:		
Preferred stock ($0.01 par value; 1,000 shares authorized; none issued and outstanding)	—	—
Common stock ($0.01 par value; 200,000 shares authorized, 88,857 shares issued and 29,056 and 29,015 shares outstanding at December 31, 2018 and September 30, 2018, respectively)	291	290
Paid-in-capital	1,176,770	1,211,051
Treasury stock, at cost (59,801 and 59,842 shares at December 31, 2018 and September 30, 2018, respectively)	(2,674,011)	(2,612,007)
Retained earnings	1,804,531	1,764,524
Accumulated other comprehensive loss	(79,686)	(76,421)
Total stockholders’ equity	227,895	287,437
Total liabilities and stockholders’ equity	$ 1,305,626	$ 1,330,467

See accompanying notes.

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FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(Unaudited)

	Quarter Ended December 31, 2018	2017 As Adjusted
	(In thousands, except per share data)	
Revenues:		
Transactional and maintenance	$194,193	$170,403
Professional services	40,808	43,128
License	27,255	18,830
Total revenues	262,256	232,361
Operating expenses:		
Cost of revenues *	76,066	74,432
Research and development	35,426	28,974
Selling, general and administrative *	100,258	90,342
Amortization of intangible assets *	1,502	1,788
Total operating expenses	213,252	195,536
Operating income	49,004	36,825
Interest expense, net	(9,676)	(6,460)
Other income (expense), net	(2,172)	513
Income before income taxes	37,156	30,878
Provision for income taxes	(2,851)	(2,001)
Net income	40,007	32,879
Other comprehensive income (loss):		
Foreign currency translation adjustments	(3,265)	3,071
Comprehensive income	$36,742	$35,950
Earnings per share:		
Basic	$1.38	$1.09
Diluted	$1.32	$1.04
Shares used in computing earnings per share:		
Basic	28,961	30,078
Diluted	30,336	31,561

* Cost of revenues and selling, general and administrative expenses exclude the amortization of intangible assets. See Note 4.
See accompanying notes.

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FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)
(In thousands)

	Common Stock						
	Shares	Par Value	Paid-in-Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balance at September 30, 2018 (As Adjusted)	29,015	$ 290	$ 1,211,051	$ (2,612,007)	$ 1,764,524	$ (76,421)	$ 287,437
Share-based compensation	—	—	21,854	—	—	—	21,854
Issuance of treasury stock under employee stock plans	466	5	(56,135)	20,692	—	—	(35,438)
Repurchases of common stock	(425)	(4)	—	(82,696)	—	—	(82,700)
Net income	—	—	—	—	40,007	—	40,007
Foreign currency translation adjustments	—	—	—	—	—	(3,265)	(3,265)
Balance at December 31, 2018	29,056	$ 291	$ 1,176,770	$ (2,674,011)	$ 1,804,531	$ (79,686)	$ 227,895

See accompanying notes.

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FAIR ISAAC CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Quarter Ended December 31,	
	2018	2017 As Adjusted
	(In thousands)	
Cash flows from operating activities:		
Net income	$40,007	$32,879
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,967	7,731
Share-based compensation	21,854	16,510
Deferred income taxes	(50)	(1,942)
Net (gain) loss on marketable securities	3,050	(90)
Provision for doubtful accounts, net	180	—
Net (gain) loss on sales of property and equipment	(22)	9
Changes in operating assets and liabilities:		
Accounts receivable	18,191	4,516
Prepaid expenses and other assets	(10,787)	(6,315)
Accounts payable	1,671	(119)
Accrued compensation and employee benefits	(28,918)	(28,672)
Other liabilities	(4,848)	(1,267)
Deferred revenue	562	5,537
Net cash provided by operating activities	48,857	28,777
Cash flows from investing activities:		
Purchases of property and equipment	(6,474)	(4,044)
Proceeds from sales of marketable securities	102	8
Purchases of marketable securities	(2,303)	(1,943)
Net cash used in investing activities	(8,675)	(5,979)
Cash flows from financing activities:		
Proceeds from revolving line of credit	103,000	79,000
Payments on revolving line of credit	(35,000)	(20,000)
Payments on debt issuance costs	—	(240)
Proceeds from issuance of treasury stock under employee stock plans	7,550	693
Taxes paid related to net share settlement of equity awards	(42,987)	(38,867)
Repurchases of common stock	(82,700)	(55,263)
Net cash used in financing activities	(50,137)	(34,677)
Effect of exchange rate changes on cash	(172)	474
Decrease in cash and cash equivalents	(10,127)	(11,405)
Cash and cash equivalents, beginning of period	90,023	105,618
Cash and cash equivalents, end of period	$79,896	$94,213
Supplemental disclosures of cash flow information:		
Cash paid for income taxes, net of refunds	$1,394	$2,221
Cash paid for interest	$13,439	$7,087
Supplemental disclosures of non-cash investing and financing activities:		
Purchase of property and equipment included in accounts payable	$433	$1,482

See accompanying notes.

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FAIR ISAAC CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Nature of Business

Fair Isaac Corporation

Incorporated under the laws of the State of Delaware, Fair Isaac Corporation ("FICO") is a provider of analytic, software and data management products and services that enable businesses to automate, improve and connect decisions. FICO provides a range of analytical solutions, credit scoring and credit account management products and services to banks, credit reporting agencies, credit card processing agencies, insurers, retailers, telecommunications providers, pharmaceutical companies, healthcare organizations, public agencies and organizations in other industries.

In these condensed consolidated financial statements, Fair Isaac Corporation is referred to as "FICO," "we," "us," "our," or "th Company."

Principles of Consolidation and Basis of Presentation

We have prepared the accompanying unaudited interim condensed consolidated financial statements in accordance with the instructions to Form 10-Q and the applicable accounting guidance. Consequently, we have not necessarily included all information and footnotes required for audited financial statements. In our opinion, the accompanying unaudited interim condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments, except as otherwise indicated) necessary for a fair presentation of our financial position and results of operations. These unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with our audited consolidated financial statements and notes thereto presented in our Annual Report on Form 10-K for the year ended September 30, 2018. The interim financial information contained in this report is not necessarily indicative of the results to be expected for any other interim period or for the entire fiscal year.

Effective October 1, 2018, we adopted Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09") using the full retrospective method. In connection with this adoption, the results and related disclosures for the comparative fiscal 2018 periods presented in this Form 10-Q were adjusted to be presented as if ASU 2014 09 had been in effect during such fiscal 2018 periods. See New Accounting Pronouncements below and Note 8. All amounts and disclosures set forth in this Form 10-Q reflect these changes.

The condensed consolidated financial statements include the accounts of FICO and its subsidiaries. All intercompany accounts and transactions have been eliminated.

Use of Estimates

We make estimates and assumptions that affect the amounts reported in the financial statements and the disclosures made in the accompanying notes. For example, we use estimates in determining the collectability of accounts receivable; the appropriate levels of various accruals; labor hours in connection with fixed-fee service contracts; the amount of our tax provision and the realizability of deferred tax assets. We also use estimates in determining the remaining economic lives and carrying values of acquired intangible assets, property and equipment, and other long-lived assets. In addition, we use assumptions to estimate the fair value of reporting units and share-based compensation. Actual results may differ from our estimates.

Revenue Recognition

Revenue is recognized when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration to which we expect to be entitled to in exchange for those goods or services.

See Note 8 for further discussion on revenues.

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New Accounting Pronouncements

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09. The standard's core principle is that a reporting entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from the contracts with customers. The guidance permits two methods of adoption: retrospectively to each prior reporting period presented ("full retrospective method"), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application ("modified retrospective method").

We adopted ASU 2014-09 in the first quarter of our fiscal 2019 using the full retrospective method which required us to adjust each prior reporting period presented. This adoption primarily affected timing of revenue recognition of license revenue on term licenses and transactional revenue on guaranteed minimum fees related to our on-premises software products. Under the new standard, we recognize revenue when control of the license is transferred to the customer, rather than at the date payments become due and payable when there are extended payment terms, or ratably over the term of the contract as required under the previous standard. In addition, revenue attributable to a software license renewal is recognized at the beginning of the applicable renewal period rather than at the signing of the renewal agreement as required under the previous standard. Additionally, under the new standard, when we enter into noncancellable contracts that provide unconditional rights to payment from our customers for services we have not yet completed or services we will provide in the near future, we present receivables — our unconditional rights to payments — and deferred revenues on a gross basis, rather than on a net basis. Finally, under the new standard we capitalize and amortize contract acquisition costs such as commissions paid for SaaS cloud services contracts in excess of one year. Following the adoption of ASU 2014-09, the revenue recognition for our other sales arrangements remained materially consistent with our historical practice.

Upon adoption of ASU 2014-09, we applied the standard's practical expedients that permit the omission of prior-period information about our performance obligations.

Adoption of the standard impacted our previously reported results as follows:

Condensed Consolidated Balance Sheets

	September 30, 2018		
	As Previously Reported	Adjustment	As Adjusted
	(In thousands)		
Accounts receivable, net	208,865	57,877	266,742
Deferred income taxes	20,117	(6,312)	13,805
Other assets	12,431	23,823	36,254
Other accrued liabilities	30,457	568	31,025
Deferred revenue	52,215	51,120	103,335
Stockholders' equity	263,737	23,700	287,437

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Condensed Consolidated Statements of Income and Comprehensive Income

	Quarter Ended December 31, 2017		
	As Previously Reported	Adjustment	As Adjusted
	(In thousands, except per share amounts)		
Revenues	235,321	(2,960)	232,361
Cost of revenues	74,359	73	74,432
Selling, general and administrative	90,296	46	90,342
Provision for income taxes	6,658	(8,659)	(2,001)
Net income	27,299	5,580	32,879
Comprehensive income	30,370	5,580	35,950
Basic earnings per share	0.91	0.18	1.09
Diluted earnings per share	0.86	0.18	1.04

Condensed Consolidated Statement of Cash Flows

	Quarter Ended December 31, 2017		
	As Previously Reported	Adjustment	As Adjusted
	(In thousands)		
Cash flows from operating activities:			
Net income	27,299	5,580	32,879
Deferred income taxes	6,717	(8,659)	(1,942)
Changes in operating assets and liabilities	(29,399)	3,079	(26,320)

Recent Accounting Pronouncements Not Yet Adopted

In February 2018, the FASB issued ASU No. 2018-02, “Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income” (“ASU 2018-02”). ASU 2018-02 allows reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act (defined below) and requires certain disclosures about stranded tax effects. The guidance is effective for fiscal years and interim periods beginning after December 15, 2018, which means it will be effective for our fiscal year beginning October 1, 2019. ASU 2018-02 should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Act is recognized. We do not believe that adoption of ASU 2018-02 will have a significant impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)” and subsequent amendments to the initial guidance: ASU 2017-13, ASU 2018-10, ASU 2018-11 and ASU 2018-20 (collectively, Topic 842). Topic 842 requires companies to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use assets. Topic 842 is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2018, which means it will be effective for our fiscal year beginning October 1, 2019. Early adoption is permitted. We are currently evaluating the impact of our pending adoption of Topic 842 on our consolidated financial statements. We expect that most of our operating leases will be recognized as right-of-use assets and corresponding lease liabilities on our consolidated balance sheets, which will increase our total assets and total liabilities upon adoption.

2. Fair Value Measurements

Fair value is defined as the price that would be received from the sale of an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The accounting guidance establishes a three-level hierarchy for disclosure that is based on the extent and level of judgment used to estimate the fair value of assets and liabilities.

- Level 1 - uses unadjusted quoted prices that are available in active markets for identical assets or liabilities. Our Level 1 assets are comprised of money market funds and certain equity securities.

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- Level 2 - uses inputs other than quoted prices included in Level 1 that are either directly or indirectly observable through correlation with market data. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; and inputs to valuation models or other pricing methodologies that do not require significant judgment because the inputs used in the model, such as interest rates and volatility, can be corroborated by readily observable market data. We do not have any assets that are valued using inputs identified under a Level 2 hierarchy as of December 31, 2018 and September 30, 2018.
- Level 3 - uses one or more significant inputs that are unobservable and supported by little or no market activity, and that reflect the use of significant management judgment. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, and significant management judgment or estimation. We do not have any assets or liabilities that are valued using inputs identified under a Level 3 hierarchy as of December 31, 2018 and September 30, 2018.

The following tables represent financial assets that we measured at fair value on a recurring basis at December 31, 2018 and September 30, 2018:

December 31, 2018	Active Markets for Identical Instruments (Level 1)	Fair Value as of December 31, 2018
	(In thousands)	
Assets:		
Cash equivalents (1)	$ 18,417	$ 18,417
Marketable securities (2)	17,210	17,210
Total	$ 35,627	$ 35,627

September 30, 2018	Active Markets for Identical Instruments (Level 1)	Fair Value as of September 30, 2018
	(In thousands)	
Assets:		
Cash equivalents (1)	$ 18,413	$ 18,413
Marketable securities (2)	18,059	18,059
Total	$ 36,472	$ 36,472

(1) Included in cash and cash equivalents on our condensed consolidated balance sheet at December 31, 2018 and September 30, 2018. Not included in these tables are cash deposits of $61.5 million and $71.6 million at December 31, 2018 and September 30, 2018, respectively.

(2) Represents securities held under a supplemental retirement and savings plan for senior management employees, which are distributed upon termination or retirement of the employees. Included in marketable securities on our condensed consolidated balance sheet at December 31, 2018 and September 30, 2018.

Where applicable, we use quoted prices in active markets for identical assets or liabilities to determine fair value. This pricing applies to our Level 1 investments. To the extent quoted prices in active markets for assets or liabilities are not available, the valuation techniques used to measure the fair values of our financial assets incorporate market inputs, which include reported trades, broker/dealer quotes, benchmark yields, issuer spreads, benchmark securities and other inputs derived from or corroborated by observable market data. This methodology would apply to our Level 2 investments. We have not changed our valuation techniques in measuring the fair value of any financial assets and liabilities during the period.

For the fair value of our derivative instruments and senior notes, see Note 3 and Note 7, respectively.

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3. Derivative Financial Instruments

We use derivative instruments to manage risks caused by fluctuations in foreign exchange rates. The primary objective of our derivative instruments is to protect the value of foreign-currency-denominated receivable and cash balances from the effects of volatility in foreign exchange rates that might occur prior to conversion to their respective functional currencies. We principally utilize foreign currency forward contracts, which enable us to buy and sell foreign currencies in the future at fixed exchange rates and economically offset changes in foreign exchange rates. We routinely enter into contracts to offset exposures denominated in the British pound, Euro, and Singapore dollar. Foreign-currency-denominated receivable and cash balances are remeasured at foreign exchange rates in effect on the balance sheet date with the effects of changes in foreign exchange rates reported in other income, net. The forward contracts are not designated as hedges and are marked to market through other income, net. Fair value changes in the forward contracts help mitigate the changes in the value of the remeasured receivable and cash balances attributable to changes in foreign exchange rates. The forward contracts are short-term in nature and typically have average maturities at inception of less than three months.

The following tables summarize our outstanding foreign currency forward contracts, by currency, at December 31, 2018 and September 30, 2018:

	December 31, 2018			
	Contract Amount			Fair Value
	Foreign Currency		US$	US$
	(In thousands)			
Sell foreign currency:				
Euro (EUR)	EUR	10,750	$12,312	$ —
Buy foreign currency:				
British pound (GBP)	GBP	8,592	$11,000	$ —
Singapore dollar (SGD)	SGD	7,211	$5,300	$ —

	September 30, 2018			
	Contract Amount			Fair Value
	Foreign Currency		US$	US$
	(In thousands)			
Sell foreign currency:				
Euro (EUR)	EUR	9,000	$10,372	$ —
Buy foreign currency:				
British pound (GBP)	GBP	8,598	$11,200	$ —
Singapore dollar (SGD)	SGD	9,580	$7,000	$ —

The foreign currency forward contracts were entered into on December 31, 2018 and September 30, 2018, respectively; therefore, their fair value was $0 on each of these dates.

Gains (losses) on derivative financial instruments are recorded in our condensed consolidated statements of income and comprehensive income as a component of other income, net, and consisted of the following:

	Quarter Ended December 31,	
	2018	2017
	(In thousands)	
Gains (losses) on foreign currency forward contracts	$(404)	$194

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4. Goodwill and Intangible Assets

Amortization expense associated with our intangible assets, which has been reflected as a separate operating expense caption within the accompanying condensed consolidated statements of income and comprehensive income, consisted of the following:

	Quarter Ended December 31,	
	2018	2017
	(In thousands)	
Cost of revenues	$494	$706
Selling, general and administrative expenses	1,008	1,082
Total	$1,502	$1,788

Cost of revenues reflects our amortization of completed technology and selling, general and administrative expenses reflects our amortization of other intangible assets. Intangible assets, gross were $110.2 million and $111.0 million as of December 31, 2018 and September 30, 2018, respectively.

Estimated future intangible asset amortization expense associated with intangible assets existing at December 31, 2018 was as follows (in thousands):

Year Ending September 30,	
2019 (excluding the quarter ended December 31, 2018)	$4,427
2020	3,618
2021	2,396
2022	2,252
2023	217
	$12,910

The following table summarizes changes to goodwill during the quarter ended December 31, 2018, both in total and as allocated to our segments:

	Applications	Scores	Decision Management Software	Total
	(In thousands)			
Balance at September 30, 2018	$585,161	$146,648	$ 69,081	$800,890
Addition from acquisitions	980	—		